MONTHLY ECONOMIC REPORT

AUGUST 2023

Highlights

- Underneath the global economic resilience there continues to be a strong divergence between the robust services sector and a weak manufacturing sector.
- The just released upward revision of 2023 global Gross Domestic Product (GDP) growth rate forecast is partly due to the stellar performance of the services sector.
- The US economic growth forecast was upgraded to 1.8% from 1.6% following continued resilience in consumption and a robust services sector. Similarly, economies in Europe with a high component of services had their growth revised upwards.
- In emerging and developing Asia (China, India, Indonesia, Australia, Japan, Korea and Singapore), growth is forecast at 5.3% in 2023, unchanged from the April forecast by the IMF.
- Closer home, the growth forecast for Sub-Saharan Africa (SSA) was cut to 3.5% from 3.6% owing to weakness in several economies.
- Commodity markets have remained fairly stable; other than oil and a few soft commodities (sugar and wheat).
- In Kenya, waning aggregate demand stemming from the erosion of purchasing power as inflation remains elevated; continues to hold back private sector activity levels.
- In Uganda, owing to the sustained improvement in business activity, increase in gross fixed capital formation and strong private consumption bolstered by easing inflationary pressures, we expect real GDP growth to accelerate to 6.0% levels in 2023.
- Tanzania's economy is poised for robust growth in 2023 and is expected to surpass 2022 growth to 5.2% on account of continued gross fixed capital formation, a strong labour market and muted inflation.
- In the near-term outlook for Rwanda, persistent inflation, tight monetary policy and weak external demand are likely to weigh on the current economic momentum.

Global Economic Overview

The services sectors surprise on the upside to push global economic performance higher.

Underneath the global economic resilience there continues to be a strong divergence between the robust services and weak manufacturing sectors.

Manufacturing-intensive economies like China and Germany are posting less than expected economic growth, while more services-based ones like the US, Spain and Italy seem to have outperformed market consensus forecasts.

This divergence was evident in the just released July *World Economic outlook Update* by the International Monetary Fund (IMF). Resultantly, the IMF revised the 2023 Gross Domestic Product (GDP) growth rate projection from 2.8% to 3.0%.

This upward revision of the 2023 global GDP growth forecast by 0.2 percentage points is attributable to several factors First, the US economic growth forecast was upgraded to 1.8% from 1.6% following continued resilience in consumption and a robust services sector. Second, the risk from the US debt ceiling concerns and the recent banking sector stress seems to have faded away.

Economies in Europe with a high component of services, e.g. Spain and Italy had their growth revised upwards. For example, UK growth will be higher (at 0.4% relative to the April 2023 projection of -0.3%) on account of a stronger-than-expected banking sector, falling energy prices and an increase in consumption momentum.

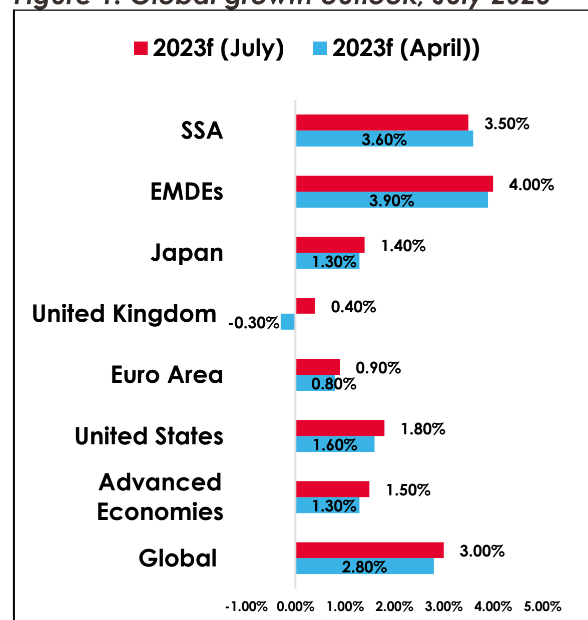
Furthermore, Russia is poised for a higher economic activity level - with GDP growing at 1.5% from 0.7% forecast earlier on in April following better outcomes in retail trade, construction and industrial production.

As has been expected since April, growth forecast for China in 2023 remained flat-lined at 5.2% compared with the April projection. In the 2Q2023, China's GDP expanded by 6.3%YoY - way below expectations. It would seem that the economy lost steam immediately after a strong start in February. At the sector level, the property sector remains fragile while weak global goods demand in Europe could increasingly weigh on exports.

Meanwhile, following favourable weather patterns in the first half of the year, Latin America recorded a surge in agricultural output. Resultantly, Brazil's and Mexico's GDP forecasts have been revised upwards by 1.2 percentage points and 0.8 percentage points, respectively.

Closer home, Sub-Saharan Africa (SSA) growth forecast was cut to 3.5% from 3.6% on account of weakness in several economies. However, growth in the key economies remains positive - with Nigeria flat-lined at 3.2% and South Africa up 0.2 percentage points to 0.3%.

Figure 1: Global growth outlook, July 2023



Source: IMF, NCBAResearch

In the US…

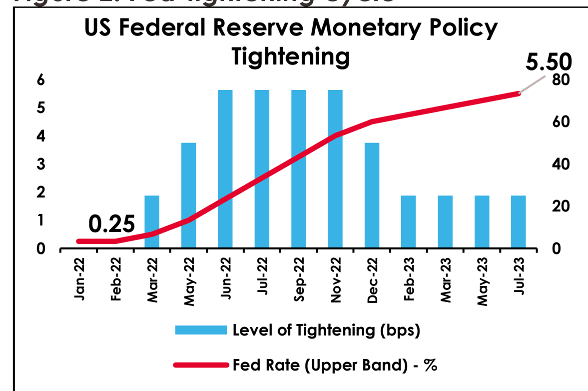
With concerns over the banking sector risks broadly out of the way, financial markets attention shifted to macroeconomic fundamentals during the month. Economic growth in both quarter one and two surprised on the upside. In the second quarter of 2023, real GDP growth accelerated to 2.4% year-on-year, picking up from a 2.0% in the first quarter. However, this robust growth may pose challenges to the current monetary policy goal of cooling down the economy to manage inflation.

Inflation did not disappoint too. Headline Consumer price Index (CPI) moderated to 3.0% year-on-year in June from 4% in May. Similarly, non-food-non-fuel CPI declined to 4.8% from 5.3% in May year-on-year. However, on a month-to-month basis, food prices rose slightly by 0.1% while average rental car expenses rose by 0.46%.

In response to this continued divergence of inflation from the target level of 2%, the Federal Open market Committee (FOMC) raised its policy rates by 25 basis points on 26th July to the 5.25-5.50% range as was widely expected by markets ahead of the decision.

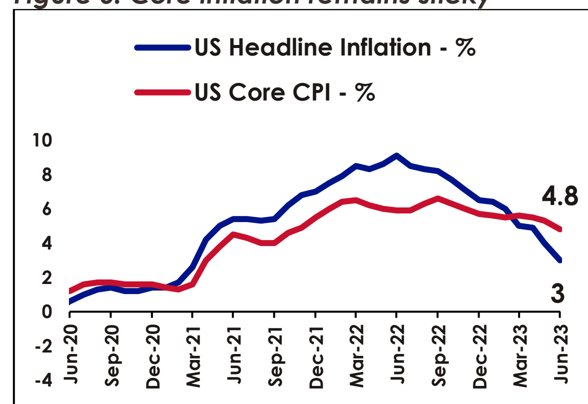
In the subsequent statement by the committee, there was little forward guidance on further rate hikes. The committee only stated that it will consider the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation.

Figure 2: Fed-tightening cycle



Source: US Federal Reserve, NCBAResearch

Figure 3: Core inflation remains sticky



Source: USBLS, NCBAResearch

While the decline in CPI does not put away the likelihood of further rate hikes later in the year, it does raise the bar for the decisions by the FOMC in September and later in November. We expect the FOMC to maintain the policy rate at 5.25-5.50% in its September meeting and then probably hike the policy rate (possibly last-of-this cycle) in November.

That said we expect future decisions by the committee to remain dependent on the data print between now and September as well as November. The FOMC chair is already on record, highlighting two employment reports and two CPI reports ahead of September as being critical inputs to the decision.

In the Euro Zone….

The Euro Area (consisting of 20 European Union member states) has recorded a high degree of heterogeneity in economic growth across the different economies. The more services-intensive countries like Italy and Spain are performing relatively well in 2023, while the more goods-and-trade-intensive ones like Germany have lagged behind.

Resultantly, the composite Euro Area Purchasing Managers' Index (PMI) has entered contractionary territory, with the June reading falling to 49.9, from 52.8 in May, and the July flash PMI at 48.9.

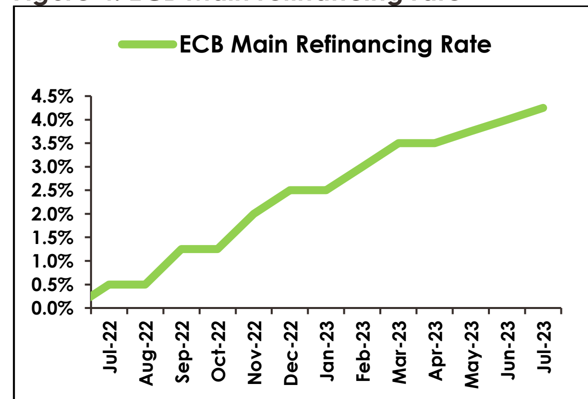
However, hard data for Germany seems to be improving, albeit, slowly. Economic output for the month of May was slightly less weak. German car production jumped by 4.9% month-on-month, construction output recorded a slower decline of 0.4%, while retail sales went up by 0.3%.

Meanwhile, falling prices for energy and intermediate goods saw inflation come down further in June, reaching 5.5%, after 6.1% in May. However, food price inflation continued to slow but remained high, at 11.6%. Services inflation remains sticky at high levels, with holidays and travel prices at elevated levels.
Resultantly, in a bid to tackle this stubbornly high inflation, the European Central Bank (ECB) increased their policy rates by 25 basis points at end July, pushing the deposit facility rate to 3.75%, the main refinancing operations rate to 4.25% and the marginal lending facility rate to 4.50%.

Interestingly, the ECB seemed to shift from stating that they have further ground to cover, to stating that the assessment of incoming data will guide as to whether or how much ground the ECB has, left to cover. It would then, seem that for the foreseeable future each ECB meeting will consider the merit of a policy rate hike or a hold. In this context, then, a policy rate pause is likely in the September meeting. Nonetheless, the macroeconomic data releases between now and September will tell how the committee arrives at its decision.

Admittedly, there is less assurance of future rate hikes by the ECB for now. Data in July from PMI surveys showed a weaker Europe. Additionally, China's Politburo meeting did not provide details on stimulus measures, and thus, less chance of significant increase in European exports to China in the remainder of the year. We thus, expect the committee to evaluate the impact of its previous tight monetary policy stance on economic growth.

Figure 4: ECB Main refinancing rate



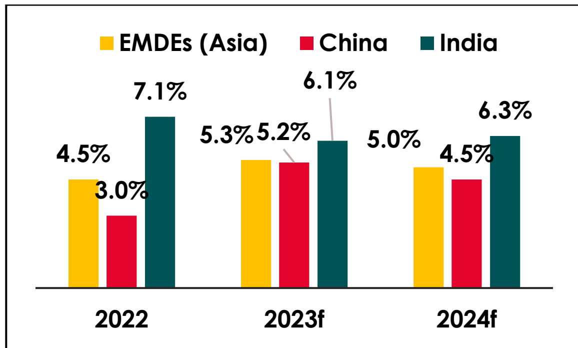
Source: ECB, NCBAResearch

Overall, the near-term economic outlook for the Euro Area remains weak, owing largely to lower aggregate consumer demand following high inflation as well as tighter financing conditions. Weaker external demand has dampened the manufacturing output. Meanwhile, it is not certain how long the services sector will retain its strength.

In Asia….

Emerging and Developing Asia (China, India, Indonesia, Australia, Japan, Korea and Singapore) is expected to grow at 5.3% in 2023, unchanged from the April forecast by the IMF.

Figure 5: Emerging and Developing Asia outlook



Source: IMF, NCBAResearch

China

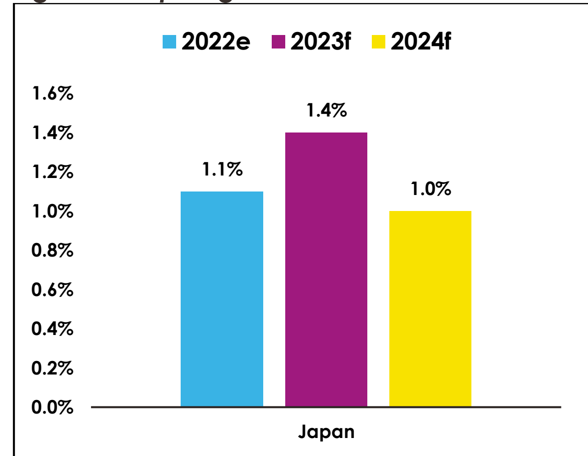
China's economy seems to have lost steam quickly after a strong start in February. Resultantly, GDP expanded by 6.3% year-on-year in 2Q2023- way below market expectations. At the sector level, the property sector remains fragile while weakness in global goods demand could increasingly weigh on exports.

Reflectively, trade contracted further in June, with imports down 6.8% year-on-year, with exports falling 12.4%. The June official PMI points to tepid activity ahead with the manufacturing component largely unchanged at 49.

Japan

There were fewer external headwinds to Japan's economy in July. Services consumption and inbound tourism remained robust. Resultantly, economic growth is projected to rise to 1.4% in 2023, relative to 1.1% in 2022 following accommodative monetary and fiscal policies and significant pent-up demand from households.

Figure 6: Japan growth outlook



Source: IMF, NCBAResearch

Following a long period of ultra-accommodative monetary policy, Japan seems to have let go of its historical challenge of deflation. Crucially, headline inflation touched 3.3% in June. Now, there is hope that the Bank of Japan (BOJ) may finally be able to sustain inflation around its 2% target.

India

In July, both the IMF and Asian Development Bank (ADB) published high growth projections for India in 2023. The ADB sees India growing at 6.4% while the IMF forecasts growth at 6.1% following strong domestic demand levels, a healthy banking and financial system and continued government development spending.

Consumption demand in India is expected to recover with improvement in both rural and urban demand as reflected in key indicators such as consumer confidence, urban unemployment, and motorbike sales.

Moreover, investment growth is projected to remain robust in 2023, underpinned by strong bank credit growth and demand for housing following a period of relatively low interest rates.

Commodities: Upward Price Pressure on Oil, Wheat, and Sugar

Following no major policy pronouncements from the long-awaited China Politburo meeting in July, commodity markets remained fairly stable in July; other than oil and a few soft commodities such as sugar and wheat.

Oil Market

In the month of July, OPEC+ (Organization of Petroleum Exporting Countries plus Russia) implemented the production cuts agreed on during their early June OPEC+ meeting. This has seen Saudi Arabia reduce its daily output by one million barrels and Russia by 500,000 barrels. Resultantly, the oil markets have tightened up leading to an increase in prices. For, example, Brent closed at \$84.40 a barrel o 27th July after being range-bound between \$72-78 over May and June.

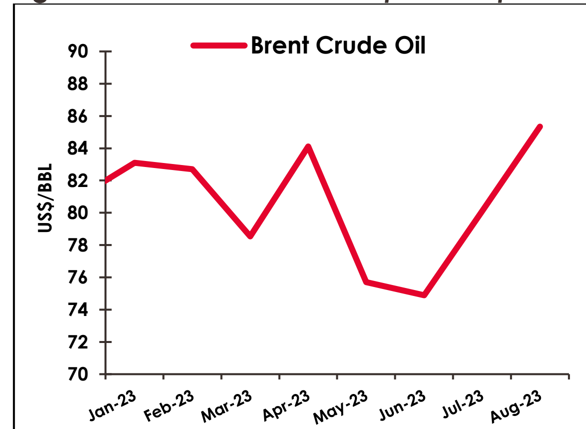
Moreover, the report by the International Monetary Fund (IMF) on 25th July, that revised upwards global output forecast for 2023 from 2.8% to 3.0% seems to have partly contributed to this price increase.

Assuming that stock drawdowns remain broadly within long-term averages and that China's demand does not surprise, the average price forecast for 2023 of \$84.0 by the IMF in April is likely to hold.

Furthermore, oil supply from fragile producers is likely to remain steady. So far, Iran production has exceeded expectations at over 3-m b/d, while geopolitics in Iraq and Libya continue to be supply positive.

Resultantly, Kenya could face continued inflationary and currency depreciation pressure from oil prices.

Figure 7: Production cuts to upend oil prices



Source: World Bank – Commodity Price Data, NCBA Research

Wheat

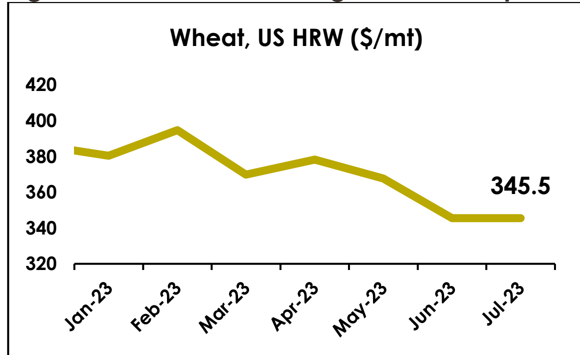
On the 17th of July 2023, Russia suspended its participation in the Black Sea agreement citing various unfulfilled demands to improve its own cereals and fertilizer exports. For example, it wanted the Russian Agricultural Bank to be reconnected to the SWIFT international payments system after being cut-off by the EU in June 2022 over its invasion of Ukraine. Prices in the global wheat markets responded by going up by between 8.5% to 11%.

We however, expect that the impact on prices will not be as high as seen in 2022 due to several reasons. Firstly, Ukraine grain exports were (already) poised to decline in 2023/24 due to lower corn and wheat harvests as well as weaker inventories. Secondly, production growth in the Americas may reduce concerns of a return to 2022 pricing. Brazil and the US are reportedly set for a good wheat crop harvest. Thirdly, today, unlike in 2022, Ukraine may be able to find alternative routes via land or the waters in Bulgaria & Romania.

Furthermore, Russia is reportedly amending its export policy to reduce or even eliminate export taxes for a "friendly country" list. Since the biggest export destinations for Russia's wheat are also economies that are seen as neutral

or friendly with Russia. E.g. Turkey, Egypt, Iran, and Saudi Arabia, then, demand pressure on wheat outside Russia will be less than in 2022.

Figure 8: Potential risks to global wheat prices



Source: World Bank – Commodity Price Data, NCBA Research

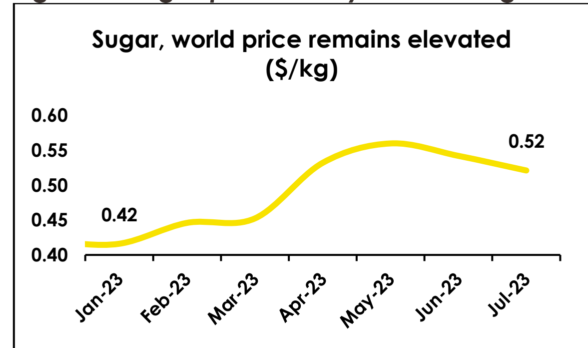
Sugar

In recent weeks, sugar market prices have rallied. Global supply has been limited following two years of a La Niña climate pattern in some of the main sugar producing economies.

Unfortunately, the outlook is not better- sugar output is now dependent on seasonal weather dynamics. We are moving to an El Niño weather pattern period which would result in the Indian and Thai production being lower.

While Brazil is having a good crop year, wet weather conditions has hampered cane harvesting. Resultantly, Brazilian mills have lost several days of operations because of rains. The surprise to the global sugar market remains potential draw down of state reserves by China to relieve the price pressure - which is unlikely.

Figure 9: Sugar prices likely to trend higher



Source: World Bank – Commodity Price Data, NCBA Research

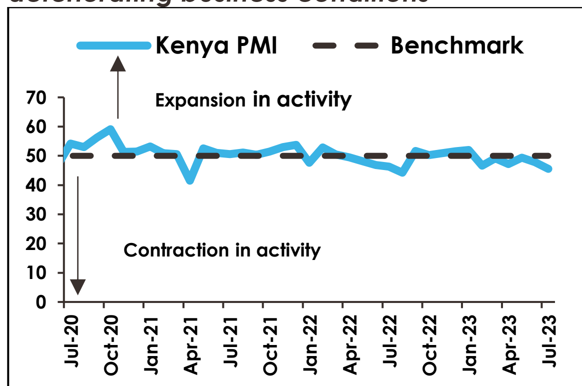
Kenya

Weak aggregate demand dampens private sector activity level

Waning aggregate demand stemming from the erosion of purchasing power as inflation remains elevated; continues to undermine private sector activity.

Illustratively, the Markit PMI declined further to 45.5 in July 2023, from 47.8 in June 2023. Headline PMI continues to signal deteriorating business conditions weighed down by sharp contractions in new orders and output – registering below the 50.0 neutral mark for the fifth consecutive month.

Figure 10: Leading indicators point to deteriorating business conditions



Source: IHS Markit, NCBAResearch

However, the significant deterioration in the PMI data for July would need to be taken in context. It was a period of significant disruption to business activity and thus, for example, some of the manufacturers had distributors sell out of inventories. It therefore does not mean a decline in their product sales. Resultantly, we would expect the order levels in August to rise as distributors rebuild inventories.

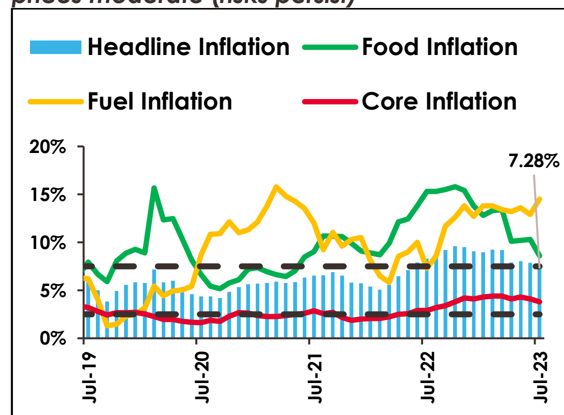
Relatedly, the June surveys by the Kenya Manufacturers Association (KAM) showed that of the surveyed manufacturers, 22% experienced more than normal purchase order levels, 28% experienced normal and 50% experienced less than normal purchase order in 2Q2023.

Inflation moderates to CBK's medium-term target band

Inflation moderated in July 2023 to 7.3% from 7.9% in June. This marks the first time in the last one year, that inflation has registered within the central bank's medium-term target band of 2.5% - 7.5%. The decline was fueled by a slower acceleration in food prices that rose by 8.6% relative to 15.3% a year earlier.

The core inflation rate declined by 30 basis points month-on-month to 3.8%. Aggregate demand is seemingly declining in response to the tighter policy stance. However, pass through effects partly remain strong especially, as a result of the currency depreciation.

Figure 11: Receding inflationary pressures as food prices moderate (risks persist)



Source: KNBS, NCBAResearch

While the implementation of the newly approved Finance Act 2023 will be critical for the sovereign's fiscal performance, it poses upside risks to inflation. Aside from this, other material risks to inflation include India's ban on non-Basmati white rice in July and uncertainties surrounding the Black Sea Grain Initiative. Moreover, we expect global food commodity price reaction to the news of the forecast El Niño weather pattern.

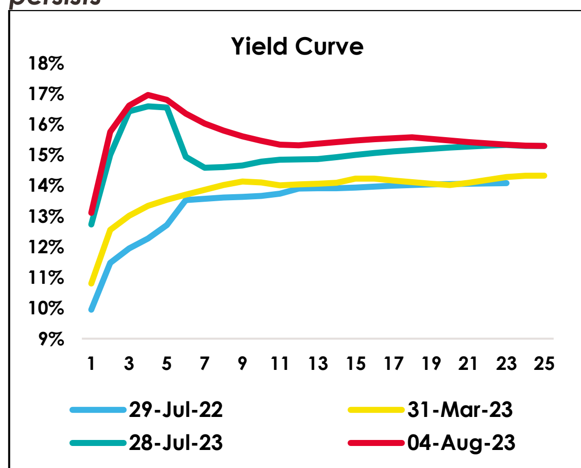
Tight monetary policy filters through to markets

In line with its price stability mandate as well as commitments made to the IMF, the Central Bank of Kenya proactively raise the policy rate to anchor inflation expectations.

In the interest rate market, tight monetary policy transmission seems to be on course- sending the overnight cost of funding in the interbank market to touch a high of 17.0% in early August from 10.2% recorded in the last day of June 2023.

Although partly driven by the sovereign's appetite in the domestic market, yields on government paper seem to have responded as well.

Figure 12: Upward pressure on yield curve persists



Source: NSE, NCBAResearch

The resultant effect of the full policy transmission into the market is expected to be tighter financial conditions owing to higher costs of credit, restrictive credit growth to the private sector and likely increase in the ratio of Non-Performing Loans (NPLs).

Already, in June 2023, private sector credit growth slowed to 12.2% from 13.2% observed in the previous month. Moreover, this is forecasted to slow further to 9.5% for the full year 2023 compared to 11.9% in 2022.

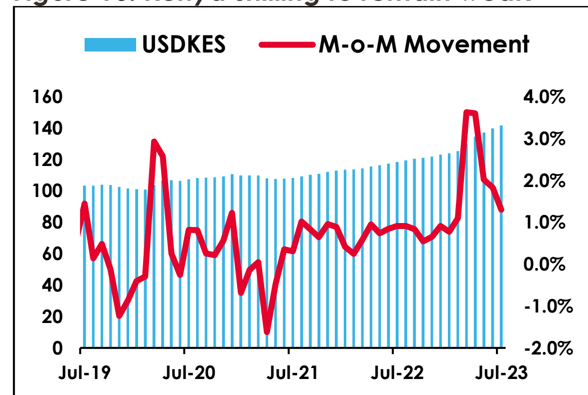
KES expected to remain weak against the major currencies

On the currency front, the KES weakened by 1.47% against the dollar in July 2023. Demand for hard currency in the domestic market remained elevated amid limited supply.

Although the official CBK FX Reserves rose to $7,377M in the month on account of the IMF disbursement - significant debt obligations have left no headroom for the regulator to provide liquidity in the domestic FX market.

According to the IMF, FX reserves are forecast to drop from USD 7,969Mn in 2022 to USD 6,983Mn in December 2023 as government settles external obligations – with the view further dampening market sentiment around the domestic unit.

Figure 13: Kenya shilling to remain weak



Source: CBK, NCBAResearch

Overall, the shilling is expected to remain weak in the near term barring any significant events to adequately moderate the deprecation.

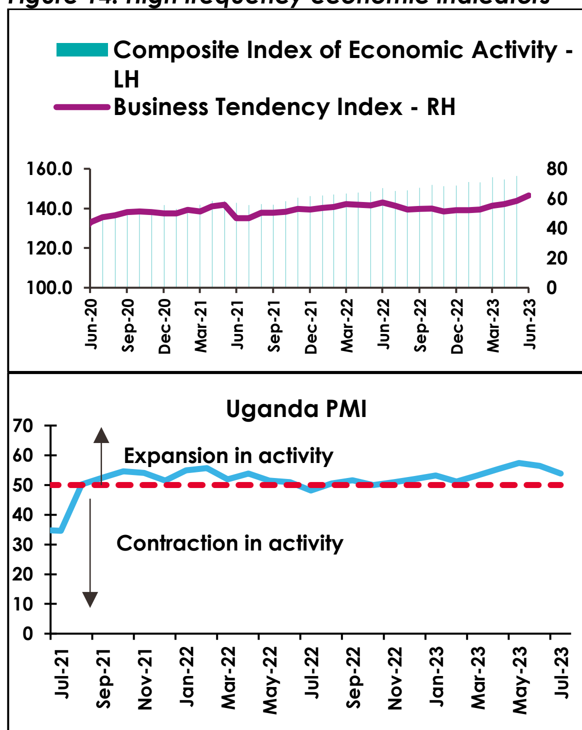
Overall, Kenya faces increased fiscal financing constraints, fragile foreign exchange reserves and disposable household income pressure in the near-term. The prospects for economic growth will thus, not be entirely positive as a result.

Uganda

Owing to the sustained improvement in business activity, increasing gross fixed capital formation and strong private consumption bolstered by easing inflationary pressures – we expect real GDP growth to accelerate to 6.0% levels in 2023.

Moreover, high frequency indicators point to a continued firming in business activity. For example, the Purchasing Manager's Index (PMI) registered at 56.4 in June 2023. Indicatively, firms were optimistic regarding further improvements in output, new orders and employment.

Figure 14: High frequency economic indicators



Source: Various, NCBAResearch

Notably, project investments into Uganda's oil sector will provide considerable tailwinds to investment for the remainder of 2023.

Against this backdrop, we expect the construction of large-scale infrastructure projects to deteriorate Uganda's trade balance, albeit marginally.

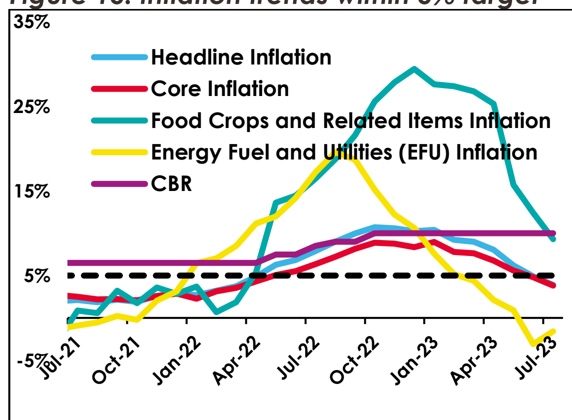
Nonetheless, Uganda's merchandise exports recorded a remarkable growth of 47%, increasing to USD 1.4Bn in 1Q2023 owing to higher export revenue from tobacco, mineral goods and maize. As a result, the trade deficit narrowed to USD 794Mn in 1Q2023 from USD 968Mn in the corresponding quarter of 2022.

Looking ahead, increased coffee exports supported by a bumper harvest and attractive international prices will contribute to sustained export receipts and counter the impact of increased importation costs.

With regard to public finances, we expect government spending to grow modestly over the medium term as the government attempts to reduce the fiscal deficit as part of its commitment to fiscal consolidation. Uganda's budget is typically made up of a high proportion of development expenditures; however, we expect that the capital expenditure budget will grow at a more moderate pace in the medium term as part of government efforts to reduce the fiscal shortfalls.

Prudent monetary policy administration as well as favorable crops harvest have sustained inflation below the Bank of Uganda's target of 5% for two consecutive months. In July, annual headline inflation declined to 3.9% from 4.90% in June 2023.

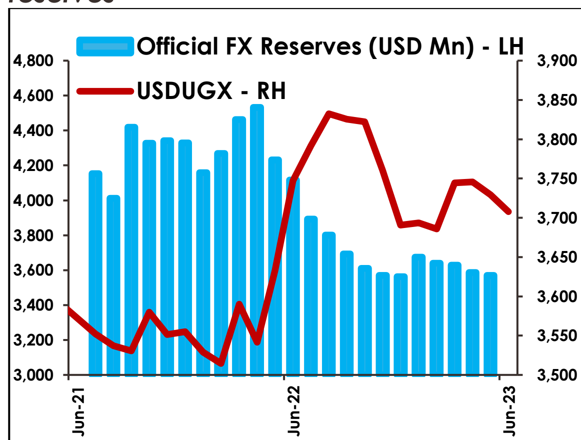
Figure 15: Inflation trends within 5% target



Source: UBoS, NCBA Research

In the local FX market, the Uganda Shilling strengthened by 55-shillings against the US dollar. The currency was supported by increased export revenue that ramped-up foreign currency flows into the market. Further, healthy capital inflows – including investments in Uganda's nascent oil sector has continued to support the domestic unit.

Figure 16: Strong shilling despite fragile reserves



Source: BOU, NCBA Research

Tanzania

Tanzania's economy is on course to expand by at least 5.2% in 2023-reflective of solid tourism sector recovery, strong investments in infrastructure projects, increased consumption expenditure and muted inflation.

Following significant expenditure of the sovereign's medium-term resources in FY 2021/22, official statistics reveal an uptick in recurrent expenditure in the FY 2022/23 by 23%.

Understandably, this higher recurrent spending is largely attributable to a rising wage bill as well as increasing debt servicing costs amid growing public debt and tighter credit conditions globally. As a result, we expect the fiscal deficit to narrow marginally, albeit remain firmly in deficit as infrastructure remains the main driver of growth under the five-year National Development Plan (2021 – 2026).

Nevertheless, Tanzania's public sector debt dynamics remain sustainable overall. While most of the country's public debt was historically comprised of concessional loans, commercial borrowing has increased in recent years.

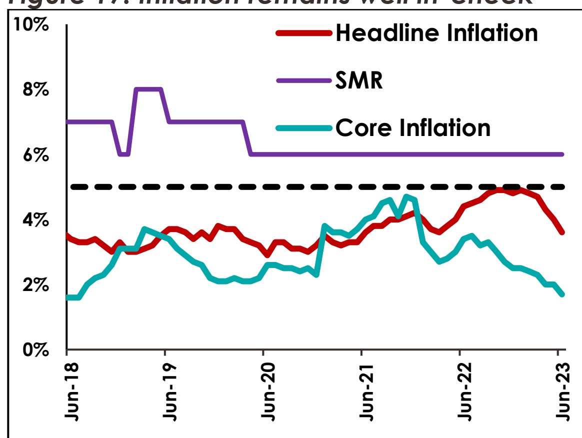
Therefore, in its pursuit to maintain sustainable debt amidst tighter external financing conditions, the sovereign has increased reliance on domestic borrowing. In the FY 2022/23 to May 2023, the government sourced TZS 4.16 Trillion in net domestic borrowing -77% increase from the corresponding period of FY 2021/23. At the same time, net foreign financing amounted to TZS 2.60 Trillion – 26% decrease from a similar period of FY 2021/23.

On the inflation front, in June 2023, headline inflation eased further to 3.6% from 4.0% recorded in May 2023. Although food inflation remains the largest contributor to price pressures, it

decreased to 7.8% from 8.5% recorded in May 2023.

Meanwhile, the core index declined to 1.7% from 2.0% in May 2023. In the reminder of 2023, we posit inflation will remain at current levels to year-end on the back of prudent monetary policy management and favorable weather. This in turn, will increase real household spending, driven by rising real wages and low unemployment.

Figure 17: Inflation remains well in-check



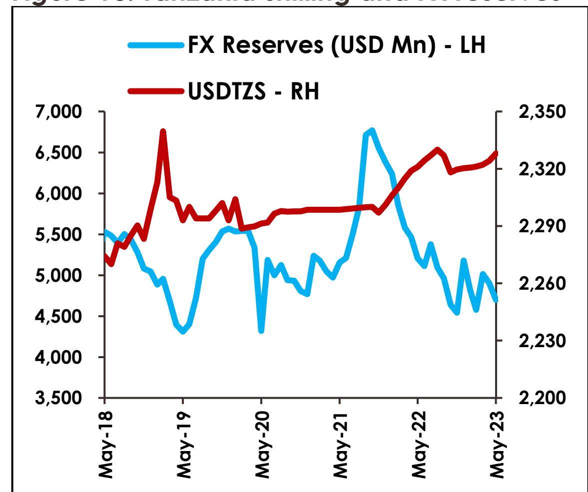
Source: NBS, NCBA Research

Against supportive monetary and fiscal policies, extension of credit to the private sector averaged 22.2% in the previous fiscal year mirroring an improved business environment. Personal loans continued to dominate total contribution to credit growth. A sustained accommodative policy environment will boost private sector growth further.

In the domestic FX market, after demonstrating stability relative to its regional peers, the outlook for the Tanzania shilling is turning less favorable. In the month, TZS ceded 1.4% of its value against the US dollar, aggravated by a series of global shocks that limited the supply of dollars in the domestic market. This necessitated continued central bank support. The BOT has drawn down its reserves to just about 4-months import cover compared to over 5.5-months cover, a year ago.

Aside from the impact on the currency, the global shocks heavily impacted the economy's current account that almost doubled to USD 4.41Bn in the period July 2022 to April 2023.

Figure 18: Tanzania shilling and FX reserves



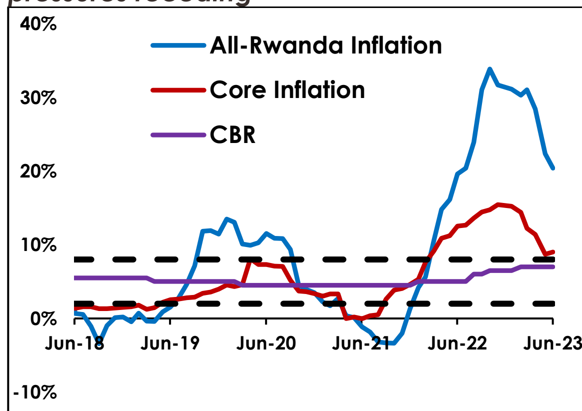
Source: BOT, NCBA Research

Rwanda

Rwanda has managed to register robust economic performance - real GDP growth touched 9.2% in the first quarter of 2023. However, in the near-term, persistent inflation, tight monetary policy and weak external demand may weigh on this economic momentum.

In this context, the recent decline in annual headline inflation- to reach 20.4% remains marginal given that food inflation has continued to rise substantially by 36% y/y. Meanwhile, core inflation (excluding food and energy) still remains elevated at recorded at 12.8%- though down slightly from 13.0% previously.

Figure 19: Inflation remains elevated but pressures receding

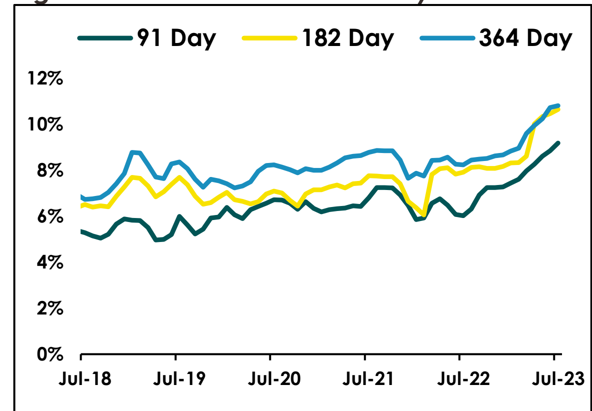


Source: NISR, NCBA Research

The Monetary Policy Committee will meet in August to decide on the path of policy given recent macroeconomic developments. With the core inflation rate sticky at 13% levels since February 2023, monetary policy is expected to remain tight to reel in inflation at a faster pace.

On the interest rate front, elevated inflation expectations have sustained the upward shift in the yield curve. In July, the returns on the 91-, 182- and 364-day papers rose by an average of 33.0bps, 19.0bps and 8.0bps closing the month at 9.284%, 10.651% and 10.796%, respectively.

Figure 20: Rwanda Treasury bill rates



Source: BNR, NCBA Research

On the external front, preliminary figures point to a widening trade deficit estimated at USD 316Mn in June 2023, from USD 292M in June 2022. The wider deficit was exacerbated by a higher import bill particularly from machinery and transport equipment. Aggravating the economy's trade balance - is the ongoing dispute with the DRC one of Rwanda's main trading partners. Potential escalation between the two nations would create barriers to trade and impact Rwanda's exports considerably.

In the domestic foreign exchange market, the USD/RWF traded relatively stable in the month of July 2023. The stability reflected consistent central bank support through dollar injections in the market. We expect official FX reserves to fall further given less external budgetary financing this fiscal year.

NCBA Research

Head Office: NCBA Centre, Mara & Ragati Roads, Upper Hill,

P O Box 30437 00100, Nairobi, Kenya

Direct Line: +254 020 288 4548 or +254 020 288 4725

Email: anthony.muli@ncbagroup.com or
samantha.njoroge@ncbagroup.com or
david.luusa@ncbagroup.com

Telex: 23205 (COMAFBANK); SWIFT BIC: CBAFKENX; Reuters Dealing: CBAF; Reuters Information: CBAN

Website: www.ncbagroup.com